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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D. C. 20554

In the Matter of	)	
	)	
BEEHIVE TELEPHONE COMPANY, INC. BEEHIVE TELEPHONE, INC. NEVADA	)	CC Docket No. 98-108
	)	
	)	
Tariff F.C.C. No. 1	)	Transmittal No. 11
	)	

To: The Commission

DIRECT CASE

Beehive Telephone Company, Inc. ("Beehive Utah") and Beehive Telephone, Inc. Nevada ("Beehive Nevada"), by their attorneys, and pursuant to the order of the Common Carrier Bureau ("Bureau"), *see Beehive Tel. Co., Inc.*, DA 98-2030 (Com. Car. Bur. Oct. 7, 1998) ("*Designation Order*"), hereby submit their direct case in the above-captioned proceeding.

Background

The Company

Beehive Utah and Beehive Nevada (collectively "Beehive" or "Company") are both controlled by their founder, Arthur W. Brothers. The Company was established in 1965 to bring the first telephone service to remote villages in Utah and Nevada. For years, Mr. Brothers served as a one-man telephone company (he hired his first full-time employee in 1980). He brought service to sparsely-populated areas using surplus equipment (often by draping old military communications cables along roadside barbed-wire fences). In its first twenty years, Beehive never turned a profit, and

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Mr. Brothers never drew more than $5,000 a year from the Company.

Beehive's subscribers are in tiny villages scattered throughout parts of nine Utah counties and two counties in Nevada. But for Beehive, most of the Company's customers would not have telephone service today, because Beehive serves areas that no other company is willing to serve.

Beehive's eight service areas are widely-dispersed over territory larger than several eastern states and comparable to an area stretching from Portland, Maine to Washington, D.C. To drive via land routes to repair system outages or respond to customer complaints can require Beehive personnel to make a 300-mile trip, mostly over dirt roads, taking two days. Even by air, the most remote parts of Beehive's network are two hours from its headquarters in Wendover, Utah.

The areas served by Beehive include some of the most formidable terrain in the United States. Of Beehive's fourteen central office locations, nine are accessible by paved roads, four by dirt roads, and one by water only. Three central office locations do not have commercial power.

Beehive constructed over 600 route miles of long distance facilities just to reach the center of the fourteen villages it serves. It takes an average of more than one mile of line for Beehive to get the local loop to each customer from their associated central switching center.

Beehive operates exchanges in areas so desolate that residents must drive three hours to the nearest convenience store. From Beehive's Partoun exchange near the West Desert High School (where students make up to a 58-mile trip to attend classes), the closest gas station is one hour away over dirt roads.

The Commission has recognized that "absent the substantial efforts of Beehive there would be no telephone service available to the residents of its operating area." *Beehive Tel. Co., Inc.*, CC Docket No. 78-240, 1986 WL 291504 *7 (Apr. 14, 1986). *See also Silver Beehive Tel. Co., Inc.* v. *Public Serv. Comm'n of Utah*, 512 P.2d 1327, 1328 (Utah 1973). Those efforts have been praised by federal and state regulators. For example, in a March 1995 speech in Houston, Texas, then Commissioner Alfred C. Sikes noted that ". . . Utah's diminutive Beehive Telephone Company offers residents in Grouse Creek, Utah advanced and feature-rich communications that rival any offered in the world." However, the provision of advanced communications under the extraordinary conditions faced by Beehive has been costly.

The Access Tariff

Beehive anticipated that eventually it would have to operate without the aid of state and federal subsidies. In 1993, after conferring with the Commission's Common Carrier Bureau ("Bureau"), Beehive commissioned a cost study to enable it to file tariffs that would allow it to continue to operate without subsidies.

In March 1994, Beehive filed its Interstate Access Tariff F.C.C. No. 1. The tariff underwent a three-month review by the Bureau. After substantial changes were made in the tariff, the Bureau permitted Beehive's tariffed access rates to become effective on July 1, 1994.

Beehive's premium and non-premium access rates were comprised of three rate elements: per-minute charges for local transport termination and local switching, and a per-minute per-mile charge for local transport facilities. Combined the three rate elements produce a per-minute rate for one mile of transport ("basis rate"). The following sets forth Beehive's initial rates:

	PREMIUM ($)	NON-PREMIUM ($)
Local Transport Facility Per Access Minute Per Mile	0.00358	0.00161
Local Transport Termination Per Access Minute	0.1470	0.0662
Local Switching Per Access Minute	0.1540	0.0693

The basic rates contained in Beehive's 1994 tariff were $.30458 for premium service and $.13711 for non-premium service. AT&T Corp. ("AT&T") was aware of those rates, but elected not to challenge them.

More than three months after its access tariff went into effect, Beehive entered into an arrangement with Joy Enterprises, Inc. ("JEI"), under which JEI provides conference bridge services,

including a chat line, within Beehive's service area. As a result, Beehive's interstate usage increased substantially in the last quarter of 1994. The increased usage allowed Beehive to reduce its basic rates.

Transmittal No. 3

Beehive's 1995 biennial access tariff filing proposed a 72.5% reduction in its basic rates. Beehive's rates were the following:

	PREMIUM ($)	NON-PREMIUM ($)
Local Transport Facility Per Access Minute Per Mile	0.00127	0.00054
Local Transport Termination Per Access Minute	0.04768	0.02142
Local Switching Per Access Minute	0.03480	0.01566

Despite the reduction in Beehive's premium rates, AT&T petitioned the Commission to investigate the cost and demand data underlying Beehive's reduced rates. The Bureau denied AT&T's petition and allowed Beehive's rates to become effective on July 1, 1995. *See 1995 Annual Access Tariff Filings of Non-Price Cap Carriers*, 10 FCC Rcd 12231, 12242 (Com. Car. Bur. 1995).

In September 1995, Beehive sought judicial review of the Commission's decision to tariff access to the 800 Service management System ("SMS/800"). *See Beehive Tel., Inc. v. FCC*, No. 95-2579 (D.C. Cir. filed Sept. 15, 1995) (*"Beehive I"*). Before that appeal, the Bureau declined to investigate Beehive's tariff filings. After the Commission's SMS/800 decision was vacated and remanded by the

Beehive I Court, the Bureau began investigating every tariff filing made by the Company.

Between August 1997 and June 1998, the Bureau initiated three tariff investigations during which Beehive incurred $125,000 in legal fees. The Commission twice disallowed all of Beehive's expenses (including its expenses in *Beehive I);* ordered refunds totaling $774,811; and prescribed rate reductions of 52% and 66%. Those actions have crippled Beehive financially. Between August 1, 1997 and July 31, 1998, the Company suffered operating losses totalling $741,162. *See infra* Exhibits 1,2.

Transmittal No. 6

The Bureau first investigated Beehive's Transmittal No. 6, which was its 1997 biennial access tariff filing. That filing proposed a 29.6% decrease in Beehive's 1995 basic rates. Beehive's 1997 rate proposal was the following:

	PREMIUM ($)	NON-PREMIUM ($)
Local Transport Facility Per Access Minute Per Mile	0.00066	0.000299
Local Transport Termination Per Access Minute	0.01815	0.008170
Local Switching Per Access Minute	0.04012	0.018050

AT&T opposed Beehive's 1997 rate reduction on the same grounds that it had objected to Beehive's 1995 rates. This time the Bureau granted AT&T's request for an investigation, allegedly because Beehive had not shown that its proposed rate levels were "justified" under some unspecified rules. *See Beehive Tel. Co., Inc.,* 12 FCC

Rcd 11695, 11697 (Com. Car. Bur. 1997).

The Bureau's decision was quite a turnaround. It had found that Beehive had justified its 1994 access rates. It also found that Beehive's 72.5% rate reduction in 1995 was justified. But when the rate reduction reached 80.7% in 1997, the Bureau decided that Beehive's rates were unjustified.

The investigation of Transmittal No. 6 was conducted in thirty-five days (from December 2, 1997 to January 6, 1998). The Commission found against Beehive because of its "failure to justify or support its proposed increase in operating expenses and its use of an unauthorized rate of return". *Beehive Tel. Co., Inc.*, 13 FCC Rcd 2736, 2742, *reconsid. denied,* 13 FCC Rcd 11795 (1998), *petition for review filed, Beehive Tel. Co., Inc.*, No. 98-1293 (D.C. Cir. June 30, 1998) (*"Investigation I"*).

The Commission's decision rested on its conclusory statement that Beehive had "failed to furnish an adequate explanation for its sharp increases in operating costs in 1995 and 1996". *Id.*, 13 FCC Rcd at 2741.[1/] Rather than eliciting additional information, or disallowing only "unexplained" expenses, the Commission disallowed all of Beehive's expenses that exceeded 25% of its total plant in service ("TPIS") in 1995 and 1996. *Id.* at 2742.

The Commission prescribed Beehive's operating costs using surrogate data filed with the National Exchange Carrier Association,

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[1/] Beehive's operating costs actually *decreased* from $3,553,932 in 1995 to $3,207,674 in 1996.

Inc. ("NECA") by carriers (31 companies in 1995 and 24 in 1996) serving between 800 and 1,000 access lines. *See Investigation I,* 13 FCC Rcd at 2742. The Commission assumed that, "[a]bsent unusual circumstances, which Beehive has not shown in this record", Beehive would have a similar ratio of total operating expenses ("TOE") to TPIS as the carriers in the sample. *Id.*

The Commission prescribed Beehive's "costs" to be 25% of its TPIS in 1995 and 1996, simply because the 25% TOE/TPIS ratio exceeded the average ratio of the Commission's sample (21.55%) and Beehive's ratio in 1994 and 1995 -- which the Commission miscalculated at 23.55% and 24.03%. *Id.* As shown below, Beehive's TOE/TPIS ratio was actually 27.66% in 1994 and 68.19% in 1995.

	TOE	TPIS	TOE/TPIS
1994	$ 1,451,218	$ 5,245,211	27.66%
1995	$ 3,553,932	$ 5,211,611	68.19%
1996	$ 3,207,674	$ 6,066,006	52.87%
1994/95	$ 5,005,150	$ 10,456,822	47.86%
1995/96	$ 6,761,606	$ 11,277,617	59.95%

By multiplying Beehive's TPIS in 1995 and 1996 ($11,277,617) by the 25% TOE/TPIS ratio, the Commission calculated that Beehive's 1995/96 TOE was $2,819,404. *See id.* at 2748. In effect, the Commission disallowed expenses totaling $3,828,730[2/], which was

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[2/] The NECA data used by the Commission excluded Customer Operations Services ("COS") expenses. Therefore, the Commission added Beehive's 1995/96 COS expenses ($113,472) to its calculation of Beehive's 1995/96 TOE. *See Investigation I,* 13 FCC at 2748-49.

56.62% of Beehive's 1995/96 TOE ($6,761,606).

The Commission prescribed a premium local switching rate of $0.009443 per minute of use and a non-premium local switching rate of $0.004249, thereby reducing Beehive's switching rates by 76.46%. *See Investigation I,* 13 FCC Rcd at 2745. The Commission concluded that the prescribed rates would permit Beehive to recover its expenses based on the Commission's "analysis of operating expenses of similar size companies." *Id.* at 2746.

Transmittal No. 8

While the Bureau was investigating Beehive's 1997 rates, Beehive filed Transmittal No. 8 to restructure its rates to conform to changes in the Commission's access charge rules. *See Access Charge Reform,* 12 FCC Rcd 15982 (1997). Beehive proposed the following rates:

	PREMIUM ($)	NON-PREMIUM ($)
Local Transport Facility Per Access Minute Per Mile	0.000533	0.000240
Local Transport Termination Per Access Minute	0.026992	0.012105
Local Switching Per Access Minute	0.028252	0.012714

Beehive did not submit supporting data at the time of its tariff filing, because it was not required to do so. *See* 47 C.F.R. § 61.39(b); *Investigation I,* 13 FCC Rcd at 11800. Nor did it make the showing called for by section 61.39(b)(5) of the Commission's Rules ("Rules") since its tariff filing did not include "end user

common line charges". 47 C.F.R. § 61.39(b)(5).

AT&T again challenged Beehive's rates, but it failed to properly serve Beehive. Consequently, the Company had one business day to respond to AT&T's contentions. By letter, Beehive asked the Commission to disregard AT&T's petition on fairness grounds. It also provided the Commission with detailed cost and demand data for the years 1995 and 1996.

The day after receiving Beehive's supporting documentation, the Bureau began a second investigation claiming that Beehive had provided "insufficient documentation" to support its rate changes. *Tariffs Implementing Access Charge Reform*, 13 FCC Rcd 163, 167 (Com. Car. Bur. 1997). The Bureau did not consider Beehive's tariff filing to be *prima facie* reasonable. *See Regulation of Small Tel. Cos.*, 2 FCC Rcd 3811, 3812-13 (1987); 47 C.F.R. § 1.773(a)(1)(iii). Nor did it specifically address Beehive's cost and demand data.

Beehive was directed to explain in detail why its TOE to TPIS ratio reflected in Transmittal No. 8 was significantly higher than (1) its ratio in 1994 and 1995 and (2) the ratio among local exchange carriers ("LECs") with a similar number of access lines. *See Beehive Tel. Co., Inc.*, 13 FCC Rcd 5142, 5145 (Com. Car. Bur. 1998). Although Beehive's rates were required to be based in its 1995/1996 cost data, see 47 C.F.R. § 61.39(b)(1)(ii), the Bureau ordered Beehive to provide detailed cost data for 1994 as well as for 1995 and 1996. *See id.* In total, Beehive was asked to provide six categories of cost data and to make five explanations. *See id.*

at 5145-48.

In its Direct Case, Beehive showed that its TOE/TPIS ratio was 27.66% in 1994 and 68.19% in 1995, not 23.55% and 24.03% as the Bureau determined. Thus, the significant increase in Beehive's TOE/TPIS ratio happened in 1995. Beehive explained that its 1995 ratio was higher because of significant increases in its plant specific and corporate operations expenses.

Beehive advised the Commission that it leased switching equipment from JEI, and it produced a copy of the Agreement for Lease of Switching Equipment, dated January 1, 1996. Under that agreement, Beehive paid JEI $84,000 per month. That cost was allocated equally to general purpose computers (Account 6124), digital electronic switching (Account 6212), and to general and administrative (Account 6728).

Beehive compared its operations with thirty-seven other LECs serving the benchmark 800 to 1,000 access lines in 1996 as reported by the Rural Utilities Services ("RUS") of the United States Department of Agriculture. The RUS data yielded the following comparison:

	Beehive	37 LECs
Exchanges	14	2.03
Access Lines Per Exchange	62	450.65
Access Lines Per Route Mile	0.74	5.25

Beehive explained that its use of leased switching equipment at four of its exchanges (Garrison, Ibapah, Park Valley and Oasis)

caused its comparatively high TOE/TPIS ratio. If it had purchased switching equipment, Beehive showed that its TOE/TPIS ratio would be reduced to 36.71%, and its rank would drop from 12th to 39th among LECs with the highest TOE/TPIS ratios.

Beehive represented that its arrangement with JEI was intended to increase its minutes of use in order to reduce its unit cost and lower its access rates. The expenses incurred to stimulate traffic were directly related to Beehive's access services, because the increased usage decreased costs to Beehive's interexchange carrier ("IXC") customers. Beehive asserted that its IXC customers benefitted from the increased use of their interexchange services and the drastic reduction in Beehive's access rates. As shown below, Beehive had reduced its basic rates by 81.7% since the JEI arrangement began in October 1994.

TRANSMITTAL NO.	PREMIUM ($)	NON-PREMIUM ($)
2	0.30458	0.13711
3	0.08375	0.03762
6	0.05893	0.026519
8	0.055777	0.025059

Beehive reported that the cost data filed in support of Transmittal No. 8 was based on more accurate financial information than the cost data filed in support of Transmittal No. 6. Beehive informed the Commission that it had nearly completed the task of reviewing its financial records dating back to 1986. That review was necessitated by the discovery that Beehive's former independent

auditor had prepared inaccurate financial statements.[3/] Beehive informed the Commission that it hired a new company accountant (Wayne A. McCulley in November 1995) and a new certified public accountant (McNeil Duncan, C.P.A. in April 1996).

Beehive disclosed that it had rebuilt its records for the years 1994, 1995 and a substantial part of 1996. It never stated that its accountant did not record its transactions in accordance with Part 32 of the Rules.

The Commission concluded its investigation of Transmittal No. 8 by essentially disregarding the cost and investment data submitted by Beehive (at a cost of over $63,000). *See Beehive Tel. Co., Inc.*, 13 FCC Rcd 12275, 12285, *reconsid. denied*, FCC 98-241, 1998 WL 664414 (Sept. 28, 1998), *petition for review filed, Beehive Tel. Co., Inc. v. FCC*, No. 98-1467 (D.C. Cir. Oct. 6, 1998)("*Investigation II*"). As the Bureau subsequently explained, the Commission found that the supporting information submitted by Beehive was "useless" because it contained "many inconsistent, questionable, and unexplained entries". *Beehive Tel. Co., Inc.*, 13 FCC Rcd 12647, 12647 (Comm. Car. Bur. 1998)("*Suspension Order*").

At the heart of *Investigation II* was the Commission's clearly erroneous (and twice repeated) finding that Beehive's Direct Case included the statement that "its accountant did not record its transactions in accordance with Part 32". 13 FCC Rcd at 12280. *See*

[3/] That discovery ultimately led Beehive Utah to file suit against its former accounting firm. *See infra* p. 44.

also Suspension Order, 13 FCC Rcd at 12648. That finding supported the following holding:

> Beehive has chosen not to justify its rates using Part 32 . . . nor has it provided any other explanation of its accounting treatment of costs that could provide assurance that its costs are presented and identified in a way that would permit development of lawful interstate access charges. This circumstance, combined with the inconsistencies in its costs presented, the questionable entries, its unexplained treatment of costs associated with JEI, and its unjustified legal expenses persuade us that Beehive has failed to meet the burden of justifying its rates in this investigation.[4/]

Believing Beehive's cost and investment information to be useless for rate development, the Commission prescribed rates utilizing a methodology similar to that employed in *Investigation I*. *See Investigation II*, 13 FCC Rcd at 12285-86. The Commission prescribed Beehive's interstate revenue requirement on the basis of the average TPIS and net investment of the sample used in its NECA study. *See id.* It derived a TOE of $943,427 by multiplying its 25% TOE/TPIS ratio by the sample's average unseparated TPIS of $3,773,709, instead of Beehive's "unreliable" TPIS. *Id.* Thus, the Commission prescribed Beehive's 1998 rates on the basis of the sample's average cost of service in 1995 and 1996. *See Investigation I*, 13 FCC Rcd at 2742.

The Commission prescribed rates that reduced Beehive's basic rates by 65.9%. The prescribed rates are shown below.

4/ *Investigation II*, 13 FCC Rcd at 12284.

	PREMIUM ($)	NON-PREMIUM ($)
Local Transport Facility Per Access Minute Per Mile	0.000181	0.000082
Local Transport Termination Per Access Minute	0.009179	0.004116
Local Switching Per Access Minute	0.009607	0.004323

The Commission ordered Beehive to refund to its IXC customers the difference between the revenues it obtained between January 1, 1998 and June 13, 1998 (the effective date of the prescribed rates) and the revenues it would have obtained during that period based on the rates prescribed by the Commission. *See Investigation II*, 13 FCC Rcd at 12287. Beehive proposed to refund $580,593 pursuant to a refund plan that has yet to be approved by the Bureau.

The ordering clauses of *Investigation II* did not mandate that the prescribed rates remain in effect for any prescribed period. *See id.* at 12287-88. Nor did the Commission prohibit Beehive from filing revised rates. *See id.*

Transmittal No. 11

In *Access Charge Reform,* the Commission directed Beehive to establish a three-part rate structure for tandem switched transport: (1) a per minute charge for traffic carried over common transport facilities between the end office and the tandem office; (2) a per minute tandem switching charge; and (3) a flat rated charge for the transport of traffic over dedicated transport facilities between wire center and tandem switching office. *See* 12 FCC Rcd at 16304.

Beehive complied on June 16, 1998 by filing its Transmittal No. 11.

Beehive elected to use Transmittal No. 11 as an opportunity to alleviate the concerns expressed by the Commission in *Investigation I* and *Investigation II*. It believed it had the statutory right to file revised rates. *See* 47 U.S.C. § 203(a)(3). And it was cognizant that small LECs are permitted to make tariff filings more frequently than every other year if they chose. *See Regulation of Small Tel. Cos.*, 2 FCC Rcd at 3814. *See also Virgin Islands Tel. Corp. v. FCC*, 989 F.2d 1231, 1233 n.1 (D.C. Cir. 1993).

Having been subjected to two tariff investigations for failing to submit supporting documentation, Beehive included in its filing 458 pages of cost and demand data compiled by its consultants, Cathey, Hutton & Associates ("Cathey Hutton"). It also filed Auditor's Reports and Financial Statements for 1994-97 prepared by Mr. Duncan. Beehive believed that its cost and demand data and audited financials fully supported the following rates:

	PREMIUM ($)	NON-PREMIUM ($)
Tandem Switched Transport Facility Per Access Minute Per Mile	0.000483	0.000483
Tandem Switched Transport Termination Per Access Minute Per Termination	0.002376	0.002376
Transport Interconnection Charge Per Access Minute	0.022009	0.009903
Local Switching Per Access Minute	0.024780	0.011151

Transmittal No. 11 was unopposed. Nevertheless, two days after Beehive appealed *Investigation I*, the Bureau initiated its third

investigation of Beehive's rates in less than one year. The Bureau summarily "rejected" two of Beehive's rate changes and instituted an investigation into the remaining revisions. *See Suspension Order*, 13 FCC Rcd at 12650.

The auditor's reports supporting Transmittal No. 11 included the statement that Beehive maintained its accounting records in accordance with Part 32 of the Rules. Nevertheless, the Bureau repeated the incorrect claim that "Beehive had stated in its direct case for Transmittal No. 8 that its cost accounts and records had not been maintained in accordance with Part 32". *Suspension Order*, 13 FCC Rcd at 12648.

Beehive promptly asked the Bureau to correct its misstatement. *See* Letter of Russell D. Lukas to James D. Schlicting at 1 (July 6, 1998).[5/] The Bureau was given copies of letters from Mr. Duncan and Mr. McCulley confirming that Beehive's expense accounts and records are maintained in accordance with Part 32. *See id.* Nevertheless, the Bureau never corrected the error.

Undersigned counsel also met with Bureau officials twice in July 1998 to express Beehive's interest in working with the staff informally to insure the Company's compliance with the Commission's access tariff requirements. The staff was advised that Beehive wanted the opportunity to address or allay concerns about its access

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[5/] Beehive brought the erroneous finding to the Commission's attention when it sought reconsideration of *Investigation II*. *See* Petition for Reconsideration, CC Docket No. 97-249, at 15 (June 30, 1998). The Commission declined to address the matter. *See Investigation II*, 1998 WL 664414 at *1.

rates in the hope of avoiding the expense of a formal tariff investigation. When the staff did not respond to its offer, Beehive was forced to seek Commission review of the *Suspension Order*. *See* Application for Review, CC Docket No. 98-108 (July 30, 1998).

In addition to asking the Commission to remedy the Bureau's refusal to correct the *Suspension Order,* Beehive contested the Bureau's finding that the revision of Beehive's local switching was "patently unlawful" because it violated the *Investigation II* rate prescription. *See Suspension Order,* 13 FCC Rcd at 12649. Asserting its statutory right to file revised rates, Beehive argued that the Bureau was without authority to simply reject Beehive's revised local switching rates. *See id.* at 5-8. The Commission has not acted on Beehive's appeal.

Designation Order

The Bureau issued its *Designation Order* on October 7, 1998, thereby dashing Beehive's hopes of avoiding the cost of another tariff Investigation. The Bureau did not use its *Designation Order* to correct its misstatement with regard to Beehive's alleged admission as to its non-compliance with Part 32.

The substance of the *Designation Order* was contained in paragraph 10. There the Bureau stated its tentative conclusions (1) that Beehive's cost support documents suffer from "problems" similar to those that caused the Commission to disregard the Transmittal No. 8 cost support; and (2) that Beehive had not met "the standard for cost support to qualify to file as a cost company under [section]

61.39." *Designation Order* at 4.

The Bureau did not designate any specific issues for resolution. Rather, the Bureau directed Beehive to comply with section 61.39(a) of the Rules by providing an explanation of "all the apparent inconsistencies and irregularities" that were allegedly "detailed" in paragraph 10. *See id.* at 5.

The day after the *Designation order* was released Beehive asked the Bureau to clarify exactly what "inconsistencies and irregularities" must be explained. *See* Letter of Russell D. Lukas to Jane E. Jackson, at 2 (Oct. 8, 1998). On October 19, 1998 (two days before Beehive's direct case deadline), the Bureau informed Beehive that it must explain: (1) why the staff's tentative conclusion that it had merely moved substantial amounts of its expenses from Utah to Nevada and from corporate operations and plant specific accounting categories to customer operations expense accounts is incorrect; (2) why it reported a 26% increase in interstate net plant in Transmittal No. 11 as compared with the interstate plant reported in its Transmittal No. 8 direct case; and (3) how it calculated its proposed switched transport facility rates, tandem switched transport termination rates, and transport interconnection charge rates. *See* Letter of Jane E. Jackson to Russell D. Lukas at 2 (Oct. 19, 1998).

Expense Reclassifications

The release of *Investigation II* roughly coincided with the completion of Mr. Duncan's audit (on June 3, 1998) and the

development of Beehive's tandem switch-related rates. That order clearly expressed the Commission's criticism of the accounting procedures employed by Beehive, and the Commission's decision to disregard entirely the cost and investment information supporting Transmittal No. 8. *See Investigation II*, 13 FCC Rcd at 12281-85. The cost support documents proffered in support of Transmittal No. 11 both reflected Mr. Duncan's audit and represented Beehive's response to *Investigation II.* And since the Commission had rejected the 1996 cost data in Transmittal No. 8, Beehive felt free to make significant, post-audit changes in its accounting treatment of its 1996 expenses.

Contrary to the Bureau's preliminary view, Beehive's new costs support documents do not present the "problems" the Commission discovered in the Transmittal No. 8 documentation. *Designation Order* at 4. Certainly, the "substantial irregularities and questionable expenses" noted in Transmittal No. 8 cannot be found in Transmittal No. 11. *Id.* (citing *Investigation II,* 13 FCC Rcd at 12281-82). The Commission's review of the Transmittal No. 8 cost data uncovered allegedly "inconsistent, questionable, and unexplained entries" in Beehive Utah's general ledger for 1995. *Investigation II,* 13 FCC Rcd at 12282 & n.46. The cost support for Transmittal No. 11 is based on 1996 and 1997 data.

The staff erred when it tentatively concluded that Beehive "merely moved" substantial expenses from Utah to Nevada and between different expense accounts. *Designation Order* at 4. Beehive

reported less 1996 operating expenses in Transmittal No. 11 than it previously did in Transmittal No. 8. Beehive Utah's reported 1996 operating expenses decreased by $173,409, while Beehive Nevada's expenses only increased $40,969. As depicted below, juxtaposition of the 1996 operating expenses in Transmittal Nos. 8 and 11 does not show that Beehive merely moved expenses from corporate operations and plant specific accounts to customer operations accounts.

	TRANSMITTAL NO. 8 ($)	TRANSMITTAL NO. 11 ($)
UT Plant Specific Operations	1,113,178	627,916
UT Plant Non-Specific Operations	319,707	288,092
UT Customer Operations Marketing		1,008,000
UT Customer Operations Services	278,501	289,451
UT Corporate Operations	1,229,803	554,321
Utah Total	2,941,189	2,767,780
NV Plant Specific Operations	117,887	156,762
NV Plant Non-Specific Operations	65,825	58,284
NV Customer Operations Marketing		
NV Customer Operations Services	15,092	15,092
NV Corporate Operations	67,681	77,316
Nevada Total	266,485	307,454
Utah and Nevada Total	3,207,674	3,075,234

The only substantial amount of expenses that Beehive "moved" was the $1,008,000 ($84,000 per month) that Beehive paid JEI in 1996 under a switching equipment lease. And Beehive did not "merely" move the 1996 JEI expenses. They were reclassified by Beehive's auditor in concurrence with *Investigation II*.

In *Investigation II,* the Commission found fault with the accounting treatment of the JEI expenses. *See 13* FCC Rcd at 12282. The auditor closely examined the evidence supporting Beehive's classification of the 1996 JEI charges as plant specific and corporate operations expenses. Mr. Duncan concluded that the equipment supplied by JEI was utilized by Beehive to implement its 1994 strategic decision to stimulate traffic to terminate on its system. He recognized that Beehive incurred the JEI costs to increase the minutes of use of its access services and to reduce the unit cost for all its customers. Accordingly, and after consultation with the RUS accounting staff (which reportedly consulted with the Bureau), Mr. Duncan decided that the 1996 JEI expenses should be reclassified to Account 6610 (Marketing). Under Part 32, that account is to "include costs incurred in developing and *implementing* promotional strategies to stimulate the purchase of products and services." 47 C.F.R. § 32.6613 (emphasis added).

While the Company did not agree entirely with the conclusion of its independent auditor, Beehive Utah reported its JEI costs as a customer operations marketing expense (Account 6610) in Transmittal No. 11. That explains why it appears that Beehive moved $1,008,000 in 1996 costs from corporate operations ($336,000) and plant specific operations ($672,000) accounts in Transmittal No. 8 to the customer operations marketing expense account in Transmittal No. 11.

The 1996 cost data for Transmittal No. 8 was compiled under the

press of Beehive's deadline to restructure its rates as mandated by the *Access Charge Reform* order. The data was based on Beehive's pre-audit accounting records. Mr. Duncan subsequently made adjustments to correct errors in the 1996 accounting records of Beehive Utah and Beehive Nevada. Those audit adjustments changed the 1996 cost support for Transmittal No. 11, and apparently created the appearance that the Company was transferring expenses between Beehive Utah and Beehive Nevada and from one expense account to another.

As noted in the Company's audited financial statements, Beehive Utah and Beehive Nevada operate under an agreement pursuant to which each may use the resources (employees, office space, premises, facilities, equipment and supplies) of the other as required for economy and convenience. Expenses are assigned from Beehive Utah to Beehive Nevada based on the percentage derived by comparing the total number of access lines of each company, or on the basis of direct labor. In situations where there is an expense that is strictly related to Beehive Utah, adjustment for this is made before applying the percentage to be transferred. The 1996 cost support for Transmittal No. 11 reflects audit adjustments in the expenses charged to Beehive Nevada.

Finally, the issue here is whether the rates filed with Transmittal No. 11 were based on costs properly recorded in accordance with Part 32. Beehive has presented its audited financial statements for 1996 and 1997 as proof that its books and

accounts conform with Part 32. Hence, the fact that changes were made in the 1996 accounting data to comply with Part 32 cannot be cited as cause to reject the cost support for Transmittal No. 11. After all, the Commission should welcome such changes having found that the cost support for Transmittal No. 8 was "useless".

Interstate Net Plant

The staff was correct to note that Beehive reported an increase in interstate net plant from Transmittal No. 8 to Transmittal No. 11 of over 26%. That increase (including the doubling of the previously reported interstate net plant for Beehive Nevada in 1996) was the result of including the weighted DEM allocator, rather than the measured or unweighted DEM allocator, in the development of the switching revenue requirement. Beehive has revised its rates using an unweighted DEM factor, calculated in accordance with 47 C.F.R. § 54.301. Revisions to Beehive's cost support documents will be delivered to the Bureau simultaneously herewith. The revised rates are set forth below.

	PREMIUM ($)	NON-PREMIUM ($)
Tandem Switched Transport Facility Per Access Minute Per Mile	0.000496	0.000496
Tandem Switched Transport Termination Per Access Minute Per Termination	0.002438	0.002438
Transport Interconnection Charge Per Access Minute	0.022590	0.010165
Local Switching Per Access Minute	0.018390	0.008275

Rate Development

Beehive calculated its tandem switched transport facility rates, tandem switched transport termination rates, and transport interconnection charge rates on the basis of historical data for the years 1996 and 1997. Rate development was based on a relationship to NECA's transport element rates. For each of the rate elements under the old transport structure (premium and non-premium local transport facility and local transport termination), Beehive multiplied its access minutes of use by NECA's tariffed rate to determine an extended price. The sum of the products of these calculations was then divided into Beehive's transport revenue requirement yielding a ratio. The ratio was then multiplied by NECA's rates for the new transport restructure elements to produce Beehive's rates for these same elements. Beehive's calculations appear at page 2 (Bates 000002) of its Transmittal No. 11 cost support documentation.

JEI Expenses

Beehive's arrangement with JEI is not unusual. It is common within the telecommunications industry for carriers to enter into agreements to stimulate traffic. *See International Audiotext Network, Inc. v. AT&T Co.*, 893 F.Supp. 1207 (S.D.N.Y. 1994), *aff'd*, 62 F.3d 69 (2d Cir. 1995). Moreover, costs incurred by carriers to stimulate usage have been recognized by the Commission as legitimate business expenses. *See AT&T's Private Payphone Commission Plan*, 3 FCC Rcd 5834, 5836 (Com. Car. Bur. 1988), *rev. denied*, 7 FCC Rcd

7135 (1992). *See also International Telecharge, Inc. v. AT&T Co.*, 8 FCC Rcd 7304, 7306 (Com. Car. Bur. 1993); *National Tel. Serv.*, 8 FCC Rcd 654, 655 (Com. Car. Bur. 1993). Beehive's expenses to stimulate usage should also be deemed legitimate and allowable. *See* 47 C.F.R. § 32.6613.

The JEI expenses Beehive incurred to stimulate traffic were related to its interstate access services, because the expenditures led to the increased use of those services and the decrease in costs to Beehive's IXCs customers. If the Commission had allowed the unopposed rates proposed in Transmittal No. 11 to become effective on July 1, 1998, Beehive would have lowered its basic rates to $.049648 for premium access service and $.023913 for non-premium service. Over a four-year period (from July 1, 1994 to July 1, 1998), Beehive would have reduced its basic rates by 83.7%.

The expenses incurred by Beehive to stimulate use of its interstate access services may be recovered through tariffed charges under current Commission policy. In the SMS/800 litigation, the Commission held that a communications service (SMS/800 database access provided by the Bell Operating Companies ("BOCs")) incidental to a common carrier transmission service (toll free service provided by IXCs) is to be regulated in the same way as the common carrier service. *See Beehive Tel., Inc. v. The Bell Operating Cos.*, 10 FCC Rcd 10562, 10566 (1995), *vacated and remanded Beehive* I (D.C. Cir. Dec. 27, 1996), *reinstated, Beehive Tel., Inc. v. The Bell Operating Cos.*, 12 FCC Rcd 17930 (1997), *petition for review filed, Beehive*

Tel. Co., Inc. v. FCC, No. 97-1662 (D.C. Cir. Oct. 31, 1997). The Commission permitted the BOCs to recover their cost of providing SMS/800 database access service through charges tariffed under section 203(a) of the Communications Act of 1934, as amended ("Act"), 47 U.S.C. § 203(a). *See Beehive Tel.,* FCC Rcd at 10564-66. *See also Provision of Access for 800 Service,* 8 FCC Rcd 1423, 1426-27 (1993). Thus, if *Beehive Tel.* was correctly decided, Beehive may use tariffed charges to recover the costs of the conference bridge services that are provided in conjunction with its interstate access services.

Interstate access service is a common carrier transmission service. *See e.g., MTS and WATS Mkt. Structure,* 93 FCC 2d 241, 254-60 (1983), *aff'd National Ass'n of Regulatory Util. Comm'rs v. FCC,* 737 F.2d 1095 (D.C. Cir. 1984), *cert. denied,* 469 U.S. 1227 (1985). Conference bridge services, including chat lines, are incidental to an access service when they function to "facilitate the use of the basic network without changing the nature of the basic telephone service." *Beehive Tel.,* 10 FCC Rcd at 10566 (quoting *LEC Validation and Billing Information for Joint Use Calling Cards,* 7 FCC Rcd 3528, 3532 (1992)). As such, conference bridge and chat line services may be regulated under Title II of the Act in the "same way" as the access (common carrier transmission) service. *Id.*

The switching equipment Beehive leases from JEI functions to stimulate the use of Beehive's system (and to facilitate the expanded use of the telephone network) without altering the nature

of its access service. Certainly, the conference bridge services and facilities permit callers to "transmit intelligence of their own design and choosing." *National Ass'n of Regulatory Util. Comm'rs v. FCC,* 533 F.2d 601, 608-09 (D.C. Cir. 1976). Thus, under *Beehive Tel.*, the JEI expenses are treated as costs for incidental communications services that may be recovered under Beehive's access tariff.

Legal Expenses

Beehive's reported corporate operations expense includes costs of legal services of $308,997 in 1996 and $410,993 in 1997. Included in the expenses Beehive posted to its legal expense accounts (Account 6725) are the costs of its legal representation before the Commission, the Public Service Commission of Utah ("UPSC") and the Nevada Public Service Commission. For example, Beehive paid communications counsel $21,208 in legal fees in 1997 in connection with regulatory matters before the Bureau (including $15,960 for the preparation and filing of Transmittal No. 6) and the Wireless Telecommunications Bureau. In addition, Beehive paid tax counsel $16,042 for legal services in 1997 relating to an audit by the Internal Revenue Service.

Litigation Costs

Also included in Beehive's legal expense accounts are "court costs, filing fees, and the costs of outside counsel, depositions, transcripts and witnesses." 47 C.F.R. § 32.6725. Booked among such litigation costs are outside counsel fees and expenses that totalled

$264,049 in 1996 and $318,525 in 1997. The chart below identifies the administrative proceedings and court actions in which those fees and expenses were incurred.

	1996 ($)	1997 ($)
SMS/800 Litigation	97,058	65,573
AT&T Litigation	30,830	129,397
MCI Litigation	42,880	
Wendover Airport Case	3,731	2,389
Kolob Mountain Proceeding	4,054	3,374
Ball Breach of Contract Case	51,436	20,972
Dangling Rope Marina Case	34,060	965
Sprint Complaint		4,023
Smith & Anderson Suit		79,752
Tariff Investigation		12,080

The Commission presumes that all litigation costs (other than those engendered by federal antitrust violations) "arise out of events occurring in the normal course of providing service to ratepayers, and that ratepayers benefit from provision of service." *Accounting for Judgments and Other Costs Associated with Litigation*, 12 FCC Rcd 5112, 5144 (1997) ("*Litigation Costs*"). Beehive is entitled to that presumption.

The relevant issue is whether the litigation arose in the ordinary course of Beehive's business of providing service to ratepayers. *See Litigation Costs*, 12 FCC Rcd at 5144. If so, Beehive's litigation expenses may be booked as a corporate operations expense and recovered from its interstate access customers in accordance

with the Parts 36 and 69 separations rules. *See Annual 1991 Access Tariff Filings*, 6 FCC Rcd 3792, 3807 (Com. Car. Bur. 1991).

Beehive presented a First Amendment defense of its litigation costs during the Commission's Transmittal No. 8 investigation. The Commission disregarded Beehive's First Amendment claim when it disregarded Beehive's allegedly "unjustified legal expenses" in *Investigation II*. *See* 13 FCC Rcd at 12283-84. And it summarily rejected Beehive's constitutional arguments in support of reconsideration. *See* 1998 WL 664414 at *1. In order to preserve the issue for appeal, Beehive will assert its First Amendment claim with respect to its 1997 litigation costs, and reassert its claim with respect to its 1996 litigation expenses.

Beehive's First Amendment right to petition the government for redress of grievances ensures meaningful access to administrative agencies and the courts. *See California Motor Transport Co.* v. *Trucking Unlimited*, 404 U.S. 508, 513 (1972). Beehive's right of access to the Commission and the courts "encompasses all the means a . . . petitioner might require to get a fair hearing". *Gilmore* v. *Lynch*, 319 F.Supp. 105, 110 (N.D. Cal. 1970), *aff'd sub nom.*, *Younger* v. *Gilmore*, 404 U.S. 15, 92 (1971). One such means that is necessarily involved in the right of access is the opportunity to seek and receive the assistance of an attorney. *Procunier* v. *Martinez*, 416 U.S. 396, 419 (1974). As was the case in *Investigation II*, a Commission ruling disallowing legal expenses incurred by Beehive infringes on its First Amendment right to petition.

Despite Beehive's request, the Commission did not promulgate a general rule in *Investigation II* under which litigation expenses can be judged as reasonable or unreasonable. Accordingly, Beehive again asks the Commission to employ a standard that accommodates the First Amendment. *See Whelan* v. *Abell*, 48 F.3d 1247, 1257 (D.C. Cir. 1995). It suggests that the Commission adopt a variation of the "sham exception" to the *Noerr-Pennington* doctrine. [6/]

The Commission should disallow expenses incurred by Beehive in petitioning agencies and the courts only if the administrative claim or lawsuit is "objectively baseless in the sense that no reasonable litigant could realistically expect success on the merits". *Professional Real Estate Investors, Inc.* v. *Columbia Pictures Industries, Inc.*, 508 U.S. 49, 60 (1993). Regardless, the Commission must avoid the void-for-vagueness doctrine (and a due process challenge) by applying a standard that will provide litigants with "real 'intelligible guidance'". *Professional Real Estate*, 508 U.S. at 60 (quoting *Allied Tube & Conduit Corp.* v. *Indian Head, Inc.*, 486 U.S. 492, 508 n.10 (1988)).

The following will describe each administrative proceeding and court action for which Beehive incurred outside counsel costs in 1996 and 1997. Where possible, Beehive will identify the legal costs it incurred in a particular agency or judicial proceeding. Such specificity is not possible with respect to complex litigation

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[6/] *See Eastern R.R. Presidents Conf.* v. *Noerr Motor Freight, Inc.*, 365 U.S. 127, 132 n.6 (1961); *United Mine Workers* v. *Pennington*, 381 U.S. 657 (1965).

which encompassed multiple, interrelated proceedings in which Beehive was represented by several attorneys or law firms. Litigation expenses in such cases were often invoiced as one matter, which now makes it difficult to apportion the expenses among the interrelated proceedings. Beehive will provide the Commission with the total legal expenses it incurred in such complex litigation.

SMS/800 Litigation

In March 1994, Beehive filed a formal complaint (File No. E-94-57) against the BOCs alleging that access to the SMS/800 database is not subject to tariff regulation under Title II of the Act. The Commission denied Beehive's complaint with finality in October 1997. *See Beehive Tel.*, 12 FCC Rcd at 17948-49. The matter is pending judicial review before the United States Court of Appeals for the District of Columbia Circuit ("D.C. Circuit") in *Beehive I*. Oral argument in the case is scheduled for October 30, 1998.

As part of its complaint against the BOCs, Beehive challenged the lawfulness of the SMS/800 Functions Tariff, Tariff F.C.C. No. 1 ("SMS/800 Tariff"), and the SMS/800 access rates. In March 1996, Database Service Management, Inc. ("DSMI"), a wholly-owned subsidiary of Bellcore, sued Beehive in the United States District Court for the District of Utah, Central Division ("District Court") for monies allegedly due under the SMS/800 Tariff. *See Database Serv. Management, Inc.* v. *Beehive Tel. Co., Inc.*, No. 2-96-CV-188-C (C.D. Utah filed Mar. 6, 1996) ("*DSMI*"). Beehive counterclaimed charging DSMI with violations of the Act and the Telecommunications

Act of 1996.

Without notice to Beehive, DSMI began disconnecting the Company's 800 numbers in May 1996. Beehive then sought a temporary restraining order and, in June 1996, the District Court ordered DSMI to cease disconnecting the Company's 800 numbers and to restore 56 such numbers to active status. Whereupon, DSMI filed an interlocutory appeal with the United States Court of Appeals for the Tenth Circuit ("10th Circuit"). *See Database Serv. Management, Inc.* v. *Beehive Tel. Co., Inc.*, No. 96-4122 (10th Cir. filed Aug. 5, 1996).

On July 13, 1998, the District Court ordered DSMI to restore all of Beehive's originally assigned 800 numbers. DSMI appealed that decision to the 10th Circuit, and it asked the court to suspend the District Court's injunction and to refer the matter to the Commission. The 10th Circuit has denied DSMI's motion to suspend the injunction. *See Database Serv. Management, Inc. v. Beehive Tel. Co., Inc.*, No. 98-4117 (10th Cir. Oct. 19, 1998).

Beehive incurred legal expenses in the SMS/800 litigation which totalled $97,058 in 1996 and $65,573 in 1997. The expenses directly related to Beehive's provision of 800 service.

Beehive undertook the SMS/800 litigation in order to protect its right to use its block of 800 numbers, all beginning with the prefix "629" or "MAX". Beehive had made a substantial investment in developing its own database to receive and re-route 800-629-XXXX calls. It also invested in creating good will value in its 629 numbers, including the expenditure of funds, research and develop-

ment, computer programming, engineering effort, customer relations, building competitive marketing strategies, negotiation of contracts, and work before governmental agencies. That investment would have been lost had DSMI succeeded in disconnecting Beehive's 800 numbers, or if Beehive had to pay the exorbitant SMS/800 Tariff rates for SMS/800 access.

If the District Court's decision is upheld by the 10th Circuit, Beehive will be able to provide an innovative 800 service at low cost to its subscribers. Thus, the legal expenses incurred by Beehive in the litigation could substantially benefit ratepayers.

Beehive's litigation costs clearly were not "illegal, duplicative, or unnecessary". *Litigation Costs*, 12 FCC Rcd at 5144 (quoting *NAACP* v. *FPC*, 425 U.S. 662, 668 (1976)). With respect to the costs incurred in the prosecution of Beehive's complaint against the BOCs, it should be noted that Beehive incurred those expenses in the exercise of its statutory right to file its complaint, *see* 47 U.S.C. § 208(a), and its First Amendment right to petition the Commission and the courts. To disallow recovery of Beehive's costs in prosecuting its complaint against the BOCs could impede Beehive's access to the Commission and two federal appeals courts. Such action would be particularly suspect in light of the fact that the Commission currently is an adverse party to Beehive before the D.C. Circuit.

AT&T Litigation

As previously discussed, AT&T petitioned the Commission in 1995 to investigate the cost and demand data underlying Beehive's 1995

annual access tariff filing (which reduced Beehive's access rates by 70%). AT&T charged that Beehive's arrangement with JEI was a scheme to "game" the Commission's ratesetting process and to overcharge its IXC customers. The Bureau promptly denied AT&T's petition. *See 1995 Annual Access Tariff Filings,* 10 FCC Rcd at 12242.

AT&T stopped paying any of Beehive's tariffed access charges in July 1995. AT&T's action had the effect of driving Beehive to the point of insolvency. Accordingly, in December 1995, Beehive filed a lawsuit against AT&T in the District Court to recover unpaid billings for access charges and late fees which totalled $2,353,619. *See Beehive Tel. Co., Inc.* v. *AT&T Corp.*, No. 95-CV-1071W (C.D. Utah filed Dec. 5, 1995).

The District Court stayed Beehive's collection suit in May 1997 to allow the Commission to adjudicate the formal complaint that AT&T had brought against Beehive in October 1996. *See AT&T Corp.* v. *Beehive Tel. Co., Inc.*, File No. E-97-04 (filed Oct. 29, 1996). That complaint reasserted the same basic claims that AT&T had presented (and the Bureau rejected) in June 1995.

The Bureau consolidated the AT&T complaint with a formal complaint Beehive brought against AT&T in March 1997. *See Beehive Tel. Co., Inc.* v. *AT&T Corp.*, File No. E-97-14 (filed Mar. 25, 1997). The consolidated complaint cases have been briefed and are pending a decision by the Commission. The District Court stay of Beehive's collection suit against AT&T remains in effect.

The AT&T litigation costs were $30,830 in 1996 and $129,397 in 1997. Beehive's District Court collection suit and its defense of the AT&T complaint were directly related to Beehive's business and the provision of its access services. Clearly, collection suits arise in the normal course of providing service. Under the Commission's current policy, Beehive is allowed to recover its costs to defend AT&T's complaint. *See Litigation Costs*, 12 FCC Rcd at 5134, 5144.

MCI Litigation

In August 1995, MCI filed a formal complaint alleging that Beehive's access rates were excessive and that the JEI arrangement constituted an unlawful practice. *See MCI Telecommunications Corp.* v. *Beehive Tel. Co., Inc.*, File No. E-95-44 (filed Aug. 29, 1995). Beehive subsequently filed suit against MCI in the District Court seeking payment of tariffed access charges. *See Beehive Telephone Co., Inc.* v. *MCI Telecomms. Corp.*, No. 95-CV-906W (C.D. Utah filed Sept. 29, 1995).

At the encouragement of the Bureau, Beehive and MCI settled their dispute. In March 1996, the Bureau dismissed MCI's complaint with prejudice. *See MCI Telecomms., Inc.* v. *Beehive Tel. Co., Inc.*, 11 FCC Rcd 2523 (Enf. Div. 1996). The District Court also dismissed Beehive's collection suit against MCI.

During the MCI litigation, Beehive incurred legal fees that totalled $42,880 in 1996. Beehive's collection suit and its defense of the MCI complaint were directly related to Beehive's business and

the provision of its access services. Such litigation is expected in the ordinary course of a LEC's business. And the Bureau held that the settlement of the MCI dispute would "serve the public interest by eliminating the need for further litigation and the expenditure of further time and resources by the parties and by the Commission." *MCI*, 11 FCC Rcd at 2523.

The Commission should not disallow the legal expenses Beehive paid in the MCI complaint case, particularly Beehive's settlement costs. Those costs were incurred at the urging of the staff and the expenditures resulted in a settlement that the Bureau found would prevent further litigation costs to Beehive (and serve the public interest).

Wendover Airport Case

In September 1991, Beehive brought an action in District Court against the Federal Aviation Administration ("FAA") and the City of Wendover to allow Beehive to have access to a heated airplane hangar at the city airport. *See Beehive Tel. Co., Inc.* v. *FAA*, No. 91-CV-1096-G (C.D. Utah filed Sept. 10, 1991). Beehive brought the lawsuit because the City had refused to lease space at the airport so that Beehive could construct a heated hangar. Moreover, the FAA and the City had prevented Beehive from using a hangar it had constructed by terminating its access to the airport runway.

Beehive had three aircraft in 1991, and needed a heated hangar facility to permit stationing the aircraft at Wendover. Beehive's service territory is so large it requires aircraft to repair system

outages and respond to customer complaints. However, the temperatures at Wendover are harsh, both in summer and winter, and the potential damage to aircraft avionics and engine(s) from heat and cold require hangaring.

The parties to the Wendover airport case have stipulated to a resolution which will allow Beehive to lease space at the airport. However, the pending bankruptcy of the City due to its inability to finance completion of airport modernization has left the settlement clouded.

Beehive incurred litigation expenses in the Wendover airport case that totalled $3,731 in 1996 and $2,389 in 1997. Those expenditures were made so that Beehive could use aircraft in the ordinary course of business. As Beehive has pointed out, air travel is essential to maintain its service in remote areas. The maintenance of Beehive's service in turn inures to the benefit of its IXC customers by facilitating interexchange service.

The Commission found that the 1996 cost of the airport suit was unjustified because "litigation regarding the construction of a heated hanger does not necessarily arise in the ordinary course of providing telecommunications service." *Investigation II,* 13 FCC Rcd at 12284. Lawsuits alleging a violation of a federal statute (other than federal antitrust lawsuits) by a carrier also do not "necessarily arise in the ordinary course of providing telecommunications service". Yet, for such lawsuits, the Commission usually retains the presumption that they arise "in the normal course of

providing service to ratepayers". *Litigation Costs,* 12 FCC Rcd at 5144. The same presumption should have applied to the airport lawsuit, where Beehive was charged with no violation of law. Beehive only sought a heated hanger that was necessary for its airplanes to be used in support of its service to ratepayers.

Finally, Part 32 allows carriers to book costs to an airplane expense account (Account 6113) for "flight crews, mechanics and ground crews". 47 C.F.R. § 32.6113. Therefore, Beehive should be able to recover the litigation expenses it had to pay to obtain access to a heated hanger that is essential to the maintenance of the aircraft serviced by mechanics or ground crews and operated by a flight crew.

Kolob Mountain Proceeding

In 1991, US WEST protested Beehive's application for UPSC certification to serve the Kolob Mountain area. *See In the Matter of Telephone Service to the Kolob Mountain Area of Washington and Iron Counties, State of Utah*, UPSC Docket No. 91-051-01 (Sept. 10, 1991). Kolob Mountain is located next to Zion National Park in southern Utah, and is an area which had been certificated to US WEST, but which had no telephone service. It is an area where much new home construction had commenced, and which was transitioning from seasonal to year-round residency. Beehive obtained commitments to take service from about 83 residents, although there are about 500 homes and cabins in the area. It has the potential for being the largest exchange on Beehive's network. In addition, there is

a summer tourist population of more than 100,000 visitors, who currently have no access to even emergency telephone service in a very rugged area.

In September 1996, the UPSC certificated Beehive to establish service in the Kolob Mountain area.

In order to bring first-time service to the Kolob Mountain area, Beehive incurred outside counsel fees and expenses totalling $4,054 in 1996 and $3,374 in 1997. Beehive undertook the project to bring telephone service to residents and visitors in the Kolob Mountain area. The litigation expenses incurred to obtain UPSC certification were a normal and necessary part of the project. By bringing telephone service to the Kolob Mountain area, Beehive obviously opened a new market for interexchange service.

Ball Breach of Contract Case

In November 1995, James E. Ball sued Beehive Utah in the Utah Court for breach of contract. *See Ball* v. *Beehive Tel. Co., Inc.*, No. 950908228CN (Utah Dist. Ct. Nov. 28, 1995). Mr. Ball claimed that Beehive Utah breached an agreement (allegedly entered into on August 31, 1995 when Mr. Brothers was not in control of Beehive Utah) under which he was to receive assistance benefits from an educational trust. He sought $120,000 in liquidated damages from Beehive Utah.

The matter was tried and, on October 7, 1998, the jury returned a verdict in favor of Beehive Utah. On a special verdict form, the jury found that there had been a mutual mistake and Mr. Ball had not

worked the required fifteen years at Beehive Utah. After the jury was discharged, both parties moved for entry of judgment in their favor on the verdict. A hearing on those motions and other open issues is scheduled for October 29, 1998.

Beehive Utah incurred $51,436 in litigation costs defending the *Ball* breach of contract suit in 1996 and $20,972 in 1997. The Commission views such contract disputes as matters arising out of the ordinary course of business, and it allows the litigation expenses engendered by those disputes to be recorded above-the-line. *See Litigation Costs*, 12 FCC Rcd at 5118. Such should be the case with respect to the *Ball* breach of contract suit.

The Company submits that the defense of the Ball suit is reasonably likely to benefit its ratepayers, including the IXCs. In the absence of a defense, Beehive Utah would have been subject to a $120,000 judgment. Payment of that judgment would have been a recoverable expense. However, if Beehive Utah obtains a judgment on the jury's verdict, having incurred less than $120,000 in legal expenses, there will be a net benefit to its ratepayers.

The Commission disallowed Beehive's expenses for the *Ball* lawsuit because it did not show "any relationship" to its service to ratepayers. *See Investigation II,* 13 FCC Rcd at 12283. Not only did Beehive show such a relationship (it repeated that showing above), but the Commission presumes such a relationship. *See Litigation Costs*, 12 FCC Rcd at 5144.

Finally, Beehive submits that its costs for the *Ball* litigation

should be disallowed only upon a finding that they were "illegal, duplicative, or unnecessary". *Litigation Costs*, 12 FCC Rcd at 5144. Such a finding cannot be made in light of the jury's verdict in Beehive's favor.

Dangling Rope Marina Case

In April 1996, Beehive petitioned the District Court for a temporary restraining order ("TRO") prohibiting the National Park Service ("NPS") from terminating Beehive's permit to operate an exchange at the Dangling Rope Marina on Lake Powell as authorized by the UPSC. *See Beehive Tel. Co., Inc.* v. *National Park Serv.*, No. 2-96-CV-362-J (C.D. Utah filed Apr. 23, 1996). The Dangling Rope Marina is arguably the most isolated spot in Utah. It is accessible only by boat or helicopter, and it is the marina closest to Rainbow Bridge, which means that more than a hundred thousand U.S. and international visitors pass through annually. There is no telephone service except for Beehive's telephone. There are life-threatening emergencies daily at Dangling Rope in the summer months. Visitors have no access to even emergency phones. The engineering aspects of Dangling Rope's service area formidable. NPS restrictions have prevented Beehive from siting relay equipment where constantly reliable radio signals facilitate optimal service, and there have been many complaints about the service reliability. Beehive has attempted to upgrade the system, but cannot unless the NPS reasonably accommodates the engineering requirements, which NPS has refused to do.

The District Court issued a TRO for Beehive and ultimately found in Beehive's favor. Beehive continues to provide telephone service at the Dangling Rope Marina.

Beehive incurred legal expenses of $34,060 in 1996 and $965 in 1997 in connection with its District Court action against NPS. Those expenditures directly related to the provisions of Beehive's telephone service, and they were not questioned by the Commission in *Investigation II*. *See* 13 FCC Rcd at 12283-84.

Sprint Complaint

In November 1996, Sprint Communications Company, L.P. ("Sprint") filed a formal complaint with the Commission in which it made allegations substantially the same as previously made by AT&T. *See Sprint Communications Co., L.P.*, File No. E-97-06 (Nov. 14, 1996). The parties settled the dispute, and the Bureau granted Sprint's request to dismiss its complaint with prejudice in January 1997. *See Sprint Communications Co., L.P. v. Beehive Tel. Co., Inc.*, 12 FCC Rcd 1383 (Enf. Div. 1997).

Beehive incurred expenses of $4,023 in reaching its settlement with Sprint in 1997. Beehive's settlement with Sprint was directly related to the Company's business and its provision of access services. Again, as was the case with the MCI complaint, the Bureau held that the settlement (and the dismissal of the Sprint complaint) served the public interest "by eliminating the need for further litigation and the expenditure of further time and resources by the parties and the Commission." *Id.* at 1383. Beehive's expenses in

the Sprint case should be allowed for the same reasons that its costs in the MCI matter are recoverable. *See supra* pp. 36-37.

Smith & Anderson Suit

In March 1997, Beehive Utah brought an action in the Utah Court against its former accountants and independent auditors, Smith & Anderson ("S&A"), charging them with negligence and fraud and deceit. *See Beehive Tel. Co., Inc. v. Smith & Anderson*, No. 970901713 (Utah Dist. Ct. Mar. 11, 1997). Beehive Utah alleged, *inter alia*, that S&A had disregarded generally accepted auditing standards in connection with its 1986-1993 audits. S&A is charged with inaccurately stating the number of Beehive Utah's common shares outstanding. That failure led to the shareholder litigation in 1995 in which Beehive Utah incurred substantial expenses and suffered financial loss. *See generally Investigation II,* 13 FCC Rcd at 12283. Beehive Utah seeks damages of not less then $500,000.

Beehive incurred legal expenses in 1997 totalling $79,752 prosecuting its suit against S&A. Those expenses are allowable, because Beehive's lawsuit against its former accountants and independent auditors must be viewed as arising out of the ordinary course of Beehive's rate-regulated business. In fact, the negligence alleged in the lawsuit contributed to the regulatory problems Beehive faces today.

Tariff Investigation

The Bureau initiated its investigation of Transmittal No. 6 on August 6, 1997. By December 31, 1997, Beehive had incurred $12,080

in legal expenses defending its rates in the investigation. Those expenses must be allowed. The Commission recognizes that the expenses of litigating a rate case before a regulatory commission are recoverable. *See Litigation Costs,* 12 FCC Rcd at 5144 n.174 (citing *Driscoll v. Edison Light & Power Co.,* 307 U.S. 104, 120-21 (1939).

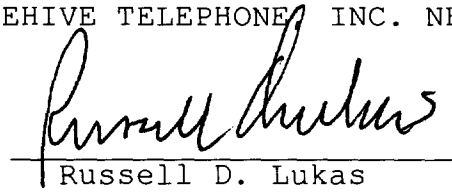
Conclusion

Beehive respectfully submits that it has provided the explanations called for by the *Designation Order* and carried its burden of demonstrating the regularity of its accounting practices and the reliability of its cost support. It has also demonstrated that its proposed rates are well within the zone of reasonableness.

Beehive recognizes that its proposed rates were miscalculated. Therefore, if it decides that the error precludes a finding that Beehive's proposed rates are just and reasonable, the Commission should prescribe the revised rates proffered by Beehive. *See supra* p. 24. Those rates were correctly developed and fully justified.

Respectfully submitted,

BEEHIVE TELEPHONE COMPANY, INC.
BEEHIVE TELEPHONE, INC. NEVADA

By 
Russell D. Lukas

Their Attorney

Lukas, Nace, Gutierrez
& Sachs, Chartered
1111 19th Street, N. W., Twelfth Floor
Washington, D. C. 20036
(202) 857-3500

BEEHIVE TELEPHONE COMPANY, INC
Income Statement
For Period From 08/01/97 to 07/31/98

REGULATED INCOME	
OPERATING REVENUES	
LOCAL NETWORK SERVICES	$ 142,589.49
NETWORK ACCESS SERVICES	$ 2,203,520.38
LONG DISTANCE SERVICES	$ 219,580.39
MISCELLANEOUS REVENUES	$ 21,140.14
UNCOLLECTIBLES	$ (556,706.01)
NET OPERATING REVENUES	$ 2,030,124.39
OPERATING EXPENSES	
PLANT SPECIFIC OPERATIONS EXP	$ 432,276.07
PLANT NONSPECIFIC OPER. EXP	$ 1,132,985.90
CUSTOMER OPERATIONS EXPENSES	$ 524,830.04
CORPORATE OPERATIONS EXPENSES	$ 737,638.27
TOTAL OPERATING EXPENSES	$ 2,827,730.28
NET REGULATED INCOME	$ (797,605.89)
OPERATING TAXES	
CORPORATE TAXES - FEDERAL	$ (136,393.00)
CORPORATE TAXES - STATE	$ (13,238.00)
PROPERTY TAXES	$ 54,024.58
REGULATORY FEES AND TAXES	$ 872.00
TOTAL OPERATING TAXES	$ (94,734.42)
NONOPERATING ITEMS	
GAINS/LOSSES ON DISPOSITIONS	$ 4,782.33
INTEREST INCOME	$ 74,550.98
OTHER NONOPERATING INC & EXP	$ (8,891.39)
INTEREST EXPENSE	$ (47,458.80)
NET NONOPERATING ITEMS	$ 22,983.12
NET INCOME	$ (679,888.35)

Exhibit 2

BEEHIVE TELEPHONE COMPANY, INC - NV
Income Statement
For Period From 08/01/97 to 07/31/98

REGULATED INCOME		
OPERATING REVENUES		
LOCAL NETWORK SERVICES	$	18,235.53
NETWORK ACCESS SERVICES	$	129,115.30
LONG DISTANCE SERVICES	$	111,827.50
MISCELLANEOUS REVENUES	$	8,273.87
UNCOLLECTIBLES	$	-
NET OPERATING REVENUES	$	267,452.20
OPERATING EXPENSES		
PLANT SPECIFIC OPERATIONS EXP	$	111,002.20
PLANT NONSPECIFIC OPER. EXP	$	86,375.58
CUSTOMER OPERATIONS EXPENSES	$	28,371.06
CORPORATE OPERATIONS EXPENSES	$	169,803.23
OPERATING TAXES		
TOTAL OPERATING EXPENSES	$	146,370.04
NET REGULATED INCOME	$	(73,363.34)
NONOPERATING ITEMS		
GAINS/LOSSES ON DISPOSITIONS	$	-
INTEREST INCOME	$	-
OTHER NONOPERATING INC & EXP	$	(12,612.54)
INTEREST EXPENSE	$	-
NET NONOPERATING ITEMS	$	12,090.44
NET INCOME	$	(61,272.90)

CERTIFICATE OF SERVICE

I, Paula L. Rogers, a secretary in the law offices of Lukas, Nace, Gutierrez & Sachs, Chartered, do hereby certify that I have on this 23rd day of October, 1998, had a copy of the foregoing DIRECT CASE hand-delivered to the following:

Jon Stover, Esquire
Competitive Pricing Division
Common Carrier Bureau
Federal Communications Commission
1919 M Street, N. W., Room 528C
Washington, D. C. 20554

International Transcription Service
1231 20th Street, N. W.
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Paula L. Rogers